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lowed by other jurisdictions. This case is illustrative of one of the main obstacles to the achievement of that purpose. The court's reasoning was faulty. Furthermore, it is unreasonable to assume that other courts will perpetuate a mistake for the sake of conformity. As a result, the uniformity of the Code will be further disrupted unless the Supreme Court of Pennsylvania refuses to recognize this decision, insofar as it relates to the creation of a security interest, as precedent.

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Damages—Rightful Recovery for Wrongful Death—The Income Tax Factor

Most problems involving the income tax concern a resolution of whether or not the tax is applicable. There *is,* however, a problem that arises because the tax is unquestionably *not* applicable. Under the Internal Revenue Code, damage awards for personal injury and wrongful death are tax exempt.[1] The recipient of such an award is allowed to exclude it from his gross income for income tax purposes. Because of this, the court in *Brooks v. United States*[2] held that the amount of damages to be given to the widow and children of a South Carolina decedent, whose wrongful death was caused by an agent of the federal government, should be computed so as to give recognition to this tax saving. This was done by using a net earnings instead of a gross earnings figure as the measure of future earnings lost as a result of decedent's death. This position taken by the court is in the minority in the United States.[3]

The question of whether to take cognizance of the tax-exempt status of the award when computing damages is an important one." "The increase in the amount of damage verdicts . . . and the high level of income taxes makes the question immediate."[4] It seems

[1] The Internal Revenue Code expressly exempts from gross income "the amount of any damages received (whether by suit or agreement) on account of personal injuries or sickness." INT. REV. CODE of 1954, § 104(a)(2). Wrongful death damages are also non-taxable. Rev. Rul. 54-19, 1954-1 CUM. BULL. 179. *See also* N.C. GEN. STAT. § 105-141(b)(5)(iv) (Supp. 1967).

[2] 273 F. Supp. 619 (D.S.C. 1967).

[3] *See* Annot., 63 A.L.R.2d 1393, 1395-96 (1959).

[4] Note, *Income Taxation and Damages for Personal Injuries,* 50 KY. L.J. 601, 601 (1962).

natural, therefore, to expect defense attorneys to make attempts to inject the issue of income tax saving into a case wherever appropriate.[5] Even though such awards have been tax-exempt since 1918,[6] however, the issue is seldom raised, and many jurisdictions, including North Carolina, have never resolved the issue.[7] In *Brooks,* the court was in a position free "to follow the commands of reasonable justice. . . ."[8] because the South Carolina court had not decided the issue and neither had the circuit court.[9]

There are logical and seemingly compelling reasons why the *Brooks* court took the position it did. The soundness of the court's position should become apparent when one considers several important factors. First, the fundamental principle or theory of damages in Anglo-American law is that of compensation for the injury caused.[10] The object is to restore the injured party (meaning the beneficiaries under the applicable statute in the case of wrongful death[11]) to the position he would have occupied had there been no injury (or death). On the other hand, it is never contemplated that

[5] Burns, *A Compensation Award for Personal Injury or Wrongful Death Is Tax Exempt: Should We Tell The Jury?,* 14 DE PAUL L. REV. 320, 321 (1965).

[6] Rev. Act of 1918, § 213(b)(6), 40 Stat. 1066 (now INT. REV. CODE of 1954, § 104(a)(2)).

[7] While North Carolina has not decided this question, the measure of damages used in wrongful death cases could accommodate a deduction of income taxes from gross expected future earnings. In Journigan v. Little River Ice Co., 233 N.C. 180, 184-85, 63 S.E.2d 183, 186 (1951), the court stated the rule as to the appropriate measure of damages to be

> the present worth of the *net* pecuniary value of the life of the deceased to be ascertained by deducting the probable cost of his own living and *usual or ordinary expenses* from his probable gross income which might be expected to be derived from his own exertions during his life expectancy. . . . [t]he end of it all being . . . to enable the jury fairly to arrive at the *net income* from which the deceased might reasonably be expected to earn from his own exertions, had his death not ensued . . . . (emphasis added).

[8] 273 F. Supp. at 632.

[9] For a collection of the state and federal court decisions which have resolved the issue, see Annot., note 3 *supra.*

[10] C. MCCORMICK, DAMAGES § 137 (1935) [hereinafter cited as MCCORMICK]; James, *Damages in Accident Cases,* 41 CORNELL L.Q. 582 (1956).

[11] Under the wrongful death statutes of most states the widow and family are the designated beneficiaries. However, in six states, including North Carolina, the estate of the decedent is the beneficiary and the action can be brought only by the personal representative. The widow and family receive the proceeds in the latter states through distribution of the estate according to the intestate succession statutes, whether or not the decedent died intestate. N.C. GEN. STAT. § 28-173, -174 (1949); Comment, *Wrongful Death Damages in North Carolina,* 44 N.C.L. REV. 402 (1966).

the injured party should be put in a better position than he would be in had the wrong not been done. The basic idea is, therefore, *compensation,* not punishment of the defendant or profit to the plaintiff.[12]

Second, an important element of damages in personal injury and especially wrongful death cases is the amount of future earnings that will now be lost as a result of the injury or death.[13] In the case of a personal injury, future earning capacity may or may not be impaired by the injury. If it is, the wrongdoer will be required to compensate the injured party to the extent of this impairment. However, in the case of wrongful death, future earning capacity is totally destroyed, and consequently, this loss of future earnings is the primary, if not the sole, element of damages recoverable.[14]

Third, "[i]f plaintiff gets in tax-free damages, an amount on which he would have had to pay taxes if he had gotten it as wages, the plaintiff is getting more than he lost."[15] That is, if plaintiff's recovery is based on lost earnings before taxes which would have been taxable had there been no injury or death[16] and is tax-free, plaintiff is being *over-compensated* by the award. This violates the guiding principle that plaintiff is to be made whole, but is not to profit.

Even though "reasonable justice" and the logical application of the underlying principle of damages would seem to require other-

[12] Some states allow recovery of punitive damages where the defendant's act is willful or amounts to gross negligence. McCORMICK §§ 79, 103. As early as 1872, the North Carolina court said, in referring to the measure of damages under the wrongful death statute, that "our statute . . . does not contemplate *solatium* for the plaintiff nor punishment for the defendant. It is therefore in the nature of pecuniary demand, the only question being; how much the plaintiff lost by the death of the injured person?" [*sic*] Collier v. Arrington, 61 N.C. 356, 358 (1872). This language is still quoted with approval today. *See, e.g.,* Gay v. Thompson, 266 N.C. 394, 398, 146 S.E.2d 425, 428 (1966).

[13] McCORMICK § 96.

[14] Wrongful death actions in the United States are wholly statutory creations and the statutes generally provide the measure of damages. The North Carolina statute provides for such damages as are "a fair and just compensation for the pecuniary injury resulting from such death." N.C. GEN. STAT. § 28-174 (1950). The basic item of damages under any such statute is the loss of future earnings caused by the death.

[15] 2 F. HARPER & F. JAMES, TORTS § 25.12 at 1326 (1956).

[16] "If the income, or a portion thereof, of the person injured or killed was exempt from liability for income tax, there would be no basis for deducting income tax on such exempt income in fixing damages for the destruction of such income." Annot., 63 A.L.R.2d 1393, 1398 (1959). An example of such tax exempt income is interest received on government bonds, certain federal pensions, etc.

wise, the view of most American courts is that the income tax consequences should not be taken to consideration in computing damage award.[17] A possible reason is a feeling on the part of the courts that to allow the damages to be reduced by the income tax payable on future earnings would be to confer some type of benefit on the wrongdoer by reducing the damages he has to pay. This is a distorted view of the problem, however. The question, in reality, is not one of reducing any damages the defendant has to pay, but one of *accurate assessment* of the plaintiff's injury. "No one would suggest that the defendant should be compelled to pay damages over and above that which the plaintiff has actually suffered by reason of the defendant's wrongdoing."[18]

Although this feeling might be the real basis for the majority position, there are several reasons explicitly advanced by the courts following the majority view. The primary reason is that future income tax liability is too conjectural.[19] Uncertainties exist as to what decedent's future tax liability would be because of the possibility of changes in the tax rates, allowable exemptions and deductions, etc. But, in computing damages, the generally accepted rule is for the jury or the court to make an estimate, if there is a reasonable basis for computation, even though the result is only approximate.[20] It would seem better to make a fair estimate of the future tax liability and reach a reasonably just result, than to ignore the tax liability completely and reach a result certainly wrong. In addition, it is no more conjectural to estimate the amount of income

[17] *See* Annot., note 3 *supra.* In England, which has an income tax provision similar to section 104(a)(2), the House of Lords overruled a long line of precedent and held that this tax exemption *should* be considered in computing damage awards. British Transport Comm'n v. Gourley, [1956] A.C. 185. For a discussion of the English cases, see Jolowiez, *Damages and Income Tax,* 1959 CAMB. L.J. 86.

[18] 60 W. VA. L. REV. 378, 381 (1958).

[19] Phoenix Indem. Co. v. Givens, 263 F.2d 858, 863 n.4 (5th Cir. 1959); Stokes v. United States, 144 F.2d 82, 87 (2d Cir. 1944); Rouse v. New York Cent. & St. L. Ry., 349 Ill. App. 139, 110 N.E.2d 266 (1953); Smith v. Penn R.R., 99 N.E.2d 501, 504 (Ohio App. 1950); Dixie Feed & Seed Co. v. Byrd, 52 Tenn. App. 619, 376 S.W.2d 745 (1963), *appeal dismissed,* 379 U.S. 15, *cert. denied,* 379 U.S. 878 (1964).

[20] 25 C.J.S. *Damages* § 26(c), at 678-80 (1966). The courts requiring use of net earnings after taxes, as the appropriate measure of future earnings lost, use estimates and do not require computation of the tax liability with mathematical precision. *See, e.g.,* O'Conner v. United States, 269 F.2d 578, 585 (2d Cir. 1959); Floyd v. Fruit Indus., Inc., 144 Conn. 659, 136 A.2d 918, 926 (1957).

taxes that decedent would have paid on his future earnings than it is to estimate the amount of future earnings he would have made, how long he would have lived, and other elements of his overall earning potential that must be and are estimated in computing such a damage award.[21]

Another reason often cited is that by making such awards tax exempt, it was Congress's intent to confer a benefit on injured persons; to base the future earnings element of a damage award on net earnings after taxes would be to subvert that intent.[22] But Congress clearly did not intend to confer a benefit by making such awards tax exempt. As the legislative history indicates,[23] Congress made the exemption because it doubted whether tort damages were "income" within the meaning of the sixteenth amendment. Such damages are more accurately characterized as a reparation of capital than as income. The "Congressional intent" argument appears to be but another example of attributing a non-existent intent to a legislature to reach an already-decided-upon result."[24] Even if it *were* Congress's intent to confer a benefit by exempting the award,

> exempting the *award* once obtained from inclusion in gross income does not necessarily have anything to do with an intention that the amount of tax that the plaintiff was paying prior to the injury should or should not be considered by the jury in arriving at the *amount of the award.* It merely says that once the proper measure of damages has been used to arrive at the award, it will not be included in gross income. . . .[25]

A third reason often cited is the "collateral source doctrine."[26] This doctrine states that compensation received from a source wholly independent of the wrongdoer will not lessen the damages recoverable from the wrongdoer. The validity of the doctrine is questionable in light of the principle that plaintiff is entitled to compensation

[21] Burns, *supra* note 5, at 324; Moffa v. Perkins Trucking Co., 200 F. Supp. 183, 188 (D. Conn. 1961).

[22] Hall v. Chicago & N.W. Ry., 5 Ill. 2d 135, 151-52, 125 N.E.2d 77, 86 (1955); Dixie Feed & Seed Co. v. Byrd, 52 Tenn. App. 619, 376 S.W.2d 745, 749 (1963), *appeal dismissed,* 379 U.S. 15, *cert. denied,* 379 U.S. 878 (1964); 9 VAND. L. REV. 543, 549-50 (1956).

[23] Nordstrom, *Income Taxes and Personal Injury Awards,* 19 OHIO ST. L.J. 212, 222 (1958). *See also* Cutler, *Taxation of the Proceeds of Litigation,* 57 COLUM. L. REV. 470 (1957); Merchants Loan & Trust Co. v. Smietanka, 255 U.S. 509 (1920).

[24] Nordstrom, *supra* note 24, at 223.

[25] *Id.* at 222.

[26] 69 HARV. L. REV. 1495, 1496 (1956); 35 N.C.L. REV. 401, 404 (1957).

only to the extent necessary to make him "whole."[27] But, even if one accepts the validity of the doctrine, it would appear to have no application to the instant problem. The two usual applications of the doctrine are where funds are paid to an insured injured party, or to the designated beneficiary in the case of death, by an insurance company, and where the injured party, or survivors in the case of death, receives a gift from a third person. An example of the latter is where a physician renders services as a gratuity. There is no analogy between receiving a tax exemption and receiving insurance proceeds. In the latter the insured has contracted and paid premiums in order to receive the insurance proceeds if the contingency insured against occurs.[28] The reason for including within the doctrine the situation where one receives collateral compensation as a gratuity is because it is thought that if the value of the gift were deducted from a damage award, it would frustrate the intent of the donor to confer a benefit. But that situation is not analogus to the instant problem since, as was noted above, it was not an intention to confer a benefit which prompted the tax exempt status of damage awards.[29]

A fourth reason advanced in some cases is that to allow presentation of evidence as to tax matters would unduly complicate the trial and cause difficulties in trial administration.[30] It is not denied that to undertake tax computations would add an element of complexity to the trial; however, tax experts could be used to assist the court. "Taxes are complicated, but are they any more complicated than annuity and mortality tables, reduction to present worth or any of a hundred problems that courts and juries solve every day?"[31] Besides, the greater burden is borne by the defense attorney who must produce and present the evidence. It would seem a better solution to let him, instead of the court, decide whether the possible savings to be had are worth the additional effort required.[32]

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[27] *See* 77 HARV. L. REV. 741 (1964).

[28] Feldman, *Personal Injury Awards: Should Tax Exempt Status Be Ignored?*, 7 ARIZ. L. REV. 272, 275 (1966).

[29] See note 24, *supra*, and accompanying text.

[30] Combs v. Chicago, St. P., M. & O. Ry., 135 F. Supp. 750 (N.D. Iowa 1955); Mitchell v. Emblade, 80 Ariz. 398, 298 P.2d 1034 (1956); Highshew v. Kushto, 235 Ind. 505, 134 N.E.2d 555 (1956); Pfister v. Cleveland, 96 Ohio App. 185, 113 N.E.2d 366 (1953), *appeal dismissed*, 159 Ohio St. 580, 112 N.E.2d 657 (1953).

[31] Morris & Nordstrom, *Personal Injury Recoveries and the Federal Income Tax Law*, 46 A.B.A.J. 274, 328 (1960).

[32] 22 OHIO ST. L.J. 225, 228-29 (1961).

Some courts refuse consideration of the tax consequences with no discussion of the problem and no real reason given for their holdding.[33] Others hold that the question should be left to the sound discretion of the trial judge,[34] and still others consider the tax factor when reviewing a damage award to determine if it is excessive.[35] The Second Circuit, as noted by the court in *Brooks*,[36] has adopted a flexible rule whereby the future earnings element of a damage award is reduced by the future tax liability where the earnings in question are in an upper income tax bracket, but no reduction is made where the earnings fall into a lower bracket.[37] This approach has now been approved and adopted by the Seventh Circuit.[38] The reasoning behind the approach is apparently that the taxes which would be payable when the earnings are in a lower bracket would be so small that the significance of deducting them would be lost in the rounding and estimating processes used in computing a damage award of this nature. While this may be true in the case of a *very* small annual income, there would seem to be few cases in which the tax is so insignificant, since a minimum of 14 per cent of an individual's gross earnings is paid in income taxes.

There appears to be a trend developing, at least in the federal courts, towards requiring a reduction for income taxes. The *Brooks* decision is recent evidence of it.[39] Although the court in *Brooks*

[33] *See, e.g.*, Boston & Me. R.R. v. Talbert, 360 F.2d 286, 291 (1st Cir. 1966).

[34] *See, e.g.*, United States v. Sommers, 351 F.2d 354, 360 (10th Cir. 1965).

[35] *See, e.g.*, Southern Pac. Co. v. Guthrie, 186 F.2d 926, 927 (9th Cir. 1951), *cert. denied*, 341 U.S. 904 (1951).

[36] 273 F. Supp. at 631.

[37] Petition of Marina Mercanto Nicaraguense, S.A., 364 F.2d 118 (2d Cir. 1966) (annual income of 11,500 dollars; held that deduction here was error); Leroy v. Sabena Belgian World Airlines, 344 F.2d 266 (2d Cir. 1965), *cert. denied*, 382 U.S. 878 (1965) (annual income of 16,000 dollars; held that deduction was appropriate); Cunningham v. Rederiet Vindeggen, S.A., 333 F.2d 308 (2d Cir. 1964) (annual income of 6,200 dollars; no deduction allowed); Montellier v. United States, 315 F.2d 180 (2d Cir. 1963) (annual income of 11-12,000 dollars—held that at this level it was discretionary with the trial court); McWeeney v. New York, N.H. & H.R.R. Co., 282 F.2d 34 (2d Cir. 1960), *cert. denied*, 364 U.S. 870 (1960) (annual income of 4,800 dollars-held that no deduction was proper).

[38] Cox v. Northwest Airlines, 379 F.2d 893 (7th Cir. 1967) (annual income of 15-20,000 dollars; held that deduction was required).

[39] For other evidence *see* Furumizo v. United States, 245 F. Supp. 981 (D. Hawaii 1965); Nollenberger v. United Air Lines, 216 F. Supp. 734 (S.D. Cal. 1963), *petition for cert. dismissed*, 379 U.S. 951, *modified on other grounds*, 335 F.2d 379 (9th Cir. 1964); Moffa v. Perkins Trucking

clearly limited its holding to wrongful death cases,[40] the same reasons would seem to exist for application of the holding in personal injury cases in which an element of damages recoverable relates to lost future earnings. But, the reasons are much more compelling in the case of wrongful death because there the damage award is primarily, if not entirely, based on loss of future earnings.

The *Brooks* decision represents a commendable effort to render "reasonable justice" in spite of many practical problems of tax computation and in the face of the prevailing line of authority. It is hoped that the decision will prompt courts which have not resolved the issue to follow suit when the issue is presented, and prompt others to revaluate their current stand.

PATRICK H. POPE

Damages—The Not So Blessed "Blessed Event"

"[T]he birth of a child may be something less than the 'blessed event.' . . ."[1] said a California Court of Appeals in *Custodio v. Bauer*.[2] The context out of which the case arose is not unique but the attitude of the court differed from similar cases where the courts adhered to more traditional concepts of the family structure.

Plaintiff in *Custodio* underwent a salpingectomy, a female sterilization operation,[3] after she and her husband decided to limit their family for health and economic[4] reasons. After the operation

Co., 200 F. Supp. 183 (D. Conn. 1961); Meehan v. Central R.R. Co., 181 F. Supp. 594 (S.D.N.Y. 1960).

[40] 273 F. Supp. at 632.

[1] Custodio v. Bauer, 59 Cal. Rept. 463, 475 (Ct. App. 1967).

[2] *Id.* at 475.

[3] Couples wishing to prevent conception through sterilization usually have the operation performed on the husband for the reason that a male sterilization (vasectomy) is a relatively simple procedure that can be performed with a local anesthetic in a doctor's office. A salpingectomy on the other hand is classified as major surgery and carries with it a certain risk of death, although the operation is simplified if performed immediately after child-bearing. However, recanalization, the process whereby the body naturally overcomes the effects of sterilization, occurs more frequently after a vasectomy than a salpingectomy. Because recanalization would be a valid defense to a cause of action based on negligence or malpractice when a pregnancy results after a sterilization operation, the plaintiff would have an easier time overcoming the defense in an unsuccessful salpingectomy.

[4] The apparent economic motivation of the Custodios was implicit in the court's opinion.